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**THE DISABLED VETERANS TAX IMPACTS THOUSANDS OF VETERANS
IN NORTH CAROLINA**

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EXECUTIVE SUMMARY

Every year, hundreds of thousands of disabled military veterans pay a “Disabled Veterans Tax” that effectively forces them to give up their disability benefits from the Department of Veterans Affairs. At the request of Reps. Watt, Price, Etheridge, McIntyre, Ballance, and Miller, this report analyzes the impact of this regressive tax on veterans in North Carolina.

Under current law, veterans with 20 years of military service are entitled to receive retirement benefits from the Department of Defense. In addition, veterans who incurred service-related disabilities are entitled to receive disability compensation benefits from the Department of Veterans Affairs. If a veteran has both 20 years of military service and a service-related disability, however, the veteran’s military retirement benefit is reduced on a dollar-for-dollar basis by the amount the veteran receives in disability compensation. This reduction in the veteran’s retirement benefits is commonly known as the “Disabled Veterans Tax.” Effectively, the disability compensation received by these veterans is taxed at a 100% rate.

This report contains the first analysis of the effect of the Disabled Veterans Tax in North Carolina. The analysis finds that the Disabled Veterans Tax has a significant impact on veterans in the state. Specifically, it finds that:

- **Thousands of veterans in North Carolina are subject to the Disabled Veterans Tax.** Approximately 25,900 veterans in North Carolina lose military retirement benefits due to the Disabled Veterans Tax. An estimated one out of every three retired veterans in the state (35%) is subject to the Disabled Veterans Tax.
- **The Disabled Veterans Tax costs veterans in North Carolina millions of dollars annually.** Statewide, veterans subject to the Disabled Veterans Tax lose \$155 million in benefits annually. This is an average of \$5,980 per affected veteran in the state. For these veterans, this amounts to a reduction in military benefits of 26%.
- **Legislation supported by Reps. Watt, Price, Etheridge, McIntyre, Ballance, and Miller to end the Disabled Veterans Tax would help many more veterans than legislation supported by House Republicans.** The members of Congress from North Carolina who requested this report have all cosponsored the Retired Pay Restoration Act of 2003 (H.R. 303). Passage of this bill would end the Disabled Veterans Tax for any veteran with over 20 years of military service, immediately restoring full benefits to 25,900 veterans in North Carolina in 2004. In contrast, the legislation supported by House Republicans would phase in the restoration of benefits to only 9,233 veterans in North Carolina. The legislation sponsored by Reps. Watt, Price, Etheridge, McIntyre, Ballance, and Miller would help almost three times as many veterans in the state as the Republican proposal.

THE DISABLED VETERANS TAX

Disabled military retirees receive benefits through two agencies, the Department of Defense and the Department of Veterans Affairs.

Veterans who have served for at least 20 years in the military receive standard retirement benefits from the Department of Defense. These benefits are determined by multiplying 2.5% of the service member's final basic pay by the number of years of service. Thus, a service member who has served for 20 years would receive annual retirement benefits equal to 50% of their final basic pay. Presently, there are an estimated 1.4 million retired veterans who receive average retirement pay of \$22,000 annually.¹

Veterans who have service-related disabilities also receive compensation through the VA. The goal of these payments is to compensate the veterans for the reduction in earnings capacity resulting from disabilities incurred during military service.² These payments are based on a scale of disability severity. This scale ranges from 10% disabled to 100% disabled. Average monthly disability payments in 2002 ranged from approximately \$100 for a veteran with a 10% disability to \$2,100 for a veteran who was 100% disabled.³

There are presently an estimated 560,000 retired service members who qualify for military retirement benefits and VA disability benefits. An 1891 law, however, bars "concurrent receipt" of both military retirement benefits and disability benefits. As a result, for veterans who receive both military retirement benefits from DOD and disability benefits from the VA, military retirement benefits are reduced dollar-for-dollar for each dollar of VA disability benefits.⁴

¹ Congressional Research Service, *Military Retirement: Major Legislative Issues* (July 10, 2003). In addition, retirees with less than 20 years service can also receive disability retirement benefits if they have either (1) completed at least 8 years of creditable military service and received a physical disability rating of 30% or greater from an evaluation board or (2) incurred a disability resulting from active duty. There are an estimated 100,000 of these service members currently receiving disability retirement.

² GAO, *Military and Veterans Benefits: Observations on the Concurrent Receipt of Military Retirement and VA Disability Compensation* (Mar. 2003) (GAO-03-575T). Additional benefits are paid to veterans who are at least 30% disabled and have dependents and to very severely disabled veterans who qualify for "special monthly compensation."

³ *Id.*

⁴ Disabled retirees can choose to have either their military retirement benefits reduced by the amount of their VA disability benefits, or their VA disability benefits reduced by the amount of their military retirement benefit. Because military retirement benefits are taxable, while VA disability benefits are not, the vast majority of retirees choose to reduce their military retirement benefits.

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The result of this policy — known as “the Disabled Veterans Tax” — is that hundreds of thousands of disabled veterans are denied billions of dollars in benefits each year. According to data from the Department of Defense, an estimated 565,000 veterans lose over \$3 billion in benefits annually due to the Disabled Veterans Tax.

LEGISLATIVE EFFORTS TO ELIMINATE THE DISABLED VETERANS TAX

Periodically, Congress has made efforts to end the restrictions on concurrent receipt of military retiree and VA disability benefits. Last Congress, for example, both the House and the Senate passed legislation to restore benefits to many veterans.⁵ These efforts were thwarted, however, when Bush Administration threatened to veto the entire DOD authorization legislation if either proposal was included in the final legislation. As a result, only extremely limited relief from the Disabled Veterans Tax could be enacted.⁶

Frustrated by Congress’ repeated failures to repeal the Disabled Veterans Tax, Reps. Watt, Price, Etheridge, McIntyre, Ballance, and Miller and other members of the House of Representatives launched a renewed legislative effort to end the tax in the 108th Congress. The goal of this effort is to enact the Retired Pay Restoration Act of 2003 (H.R. 303). This legislation would eliminate the prohibition on concurrent receipt of veterans’ retirement and disability benefits. H.R. 303 currently has 373 cosponsors in the House.

⁵ The House legislation would have allowed veterans with disability ratings of 60% or greater to receive both military retirement benefits and VA disability benefits. This legislation would have restored benefits to an estimated 111,000 veterans. The Senate legislation would have allowed all disabled veterans to receive both military retirement pay and VA disability benefits. See Congressional Research Service, *Concurrent Receipt of Military Retirement and VA Disability Benefits: Budgetary Issues* (Nov. 15, 2002).

⁶ The final version of the legislation provided for special pay, known as Combat-Related Special Compensation, not subject to the offset only for veterans who suffered an injury for which they received a Purple Heart or who had a severe disability rated at 60% or more resulting from armed conflict, hazardous service, training activities that simulate war, or war-related circumstances. H.R. 4546, *FY 2003 DOD Authorization Act* (Nov. 2002). This law requires DOD to make a complicated calculation concerning each disability of each disabled retiree to determine which disabilities are combat related and therefore qualify for the special pay. The final legislation was so narrowly crafted that it allows only an estimated 33,000 veterans to receive both military retirement and disability benefits.⁶ And it is so complicated that it may take years for retirees to prove their entitlement to special pay. For example, in cases involving a disability resulting from a retiree’s collision with an armored tank, payment of special compensation will depend upon whether the tank hit the retiree or the retiree hit the tank. Department of Defense, *Combat-Related Special Compensation (CRSC) Web Site* (2003) (online at <https://www.dmdc.osd.mil/crsc/>).

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Republican leaders in Congress oppose H.R. 303 and have not allowed a vote on the bill despite its broad support.⁷ In response, Rep. Jim Marshall (D-GA) filed a “discharge petition” on June 12, 2003, that would force House leaders to allow a vote on the bill.⁸ If the discharge petition receives the signatures of 218 House members (a majority of the House), House rules require a vote on the legislation. There are presently 200 Democratic members, two Republican members, and one independent member of the House who have signed the discharge petition. The six representatives who requested this report have all signed the discharge petition.

In October 2003, in an effort to avert passage of H.R. 303, Republican leaders in the House announced their own plan to reduce the burden of the disabled veterans tax.⁹ Under this proposal, veterans with disability ratings of 50% or more would have their portion of the Disabled Veterans Tax eliminated over a ten-year period. Because of this long phase-in period, reductions of the tax would be very small in the early years of the proposal, and these veterans would not receive their full benefits until 2014.¹⁰ The legislation would do nothing for most veterans currently paying the Disabled Veterans Tax who have disabilities rated 50% or less.

Veterans groups have criticized this Republican proposal because it fails to eliminate the Disabled Veterans Tax for all veterans. DOD data indicate that the proposal would provide relief for approximately 170,000 veterans, fewer than one of every three veterans currently paying the Disabled Veterans Tax. According to the American Legion, “creating a two-tiered benefits system, that favors one group of service-disabled military retirees over another, is not the answer.”¹¹

OBJECTIVE AND METHODOLOGY

This report was requested by Rep. Melvin L. Watt, who represents the 12th Congressional District of North Carolina, Rep. David E. Price, who represents the 4th Congressional District of North Carolina, Rep. Bob Etheridge, who represents the 2nd Congressional District of North Carolina, Rep. Mike McIntyre, who

⁷ House Speaker Dennis Hastert, *Transcript of Press Conference* (June 26, 2003) (online at <http://releases.usnewswire.com/GetRelease.asp?id=137-06272003>).

⁸ Discharge Petition 108-002.

⁹ *Vets Could Collect More Benefits*, Washington Post (Oct. 17, 2003).

¹⁰ In addition, the proposal would expand the 2002 legislation passed by Congress, providing that all veterans with a disability resulting from armed conflict receive Combat-Related Special Compensation.

¹¹ American Legion, *Legion: Disability Tax Compromise Unsatisfactory* (Oct. 16, 2003)

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represents the 7th Congressional District of North Carolina, Rep. Frank W. Ballance, Jr., who represents the 1st Congressional District of North Carolina, and Rep. Brad Miller, who represents the 13th Congressional District of North Carolina. Reps. Watt, Price, Etheridge, McIntyre, Ballance, and Miller requested this report in order to determine (1) the impact of the Disabled Veterans Tax on veterans in the state and in their district; (2) the potential benefits for veterans in the state and their district from enactment of H.R. 303; and (3) the benefits that disabled veterans in the state and their district would receive under the Republican proposal compared to the benefits that they would receive under H.R. 303.

To conduct this analysis, the Special Investigations Division obtained and analyzed data from the Office of the Actuary of the Department of Defense. The data includes zip code-level data on the total number of military retirees who are forced to pay the Disabled Veterans Tax. It also includes data on the monthly cost of the tax. Separate data obtained from the DOD actuary included zip code-level data estimating the impact of the Republican proposal on disabled veterans. Using these databases, the Special Investigations Division analyzed the impact of the Disabled Veterans Tax on veterans in the state and compared the benefits to veterans with those provided by the House Republican proposal.¹²

FINDINGS

The Disabled Veterans Tax Affects Thousands of Veterans in North Carolina

There are 73,289 veterans in North Carolina who receive military retirement benefits. Of these veterans, 25,890 veterans — 35% — also receive disability benefits from the VA and are subject to the Disabled Veterans Tax.

¹² All data in the DOD database was available at the 5-digit zip code level. Because 5-digit zip codes can sometimes be split between two or more congressional districts, the analysis assumes that when a zip code is split between two districts, half of the impacted veterans in the zip code are in each congressional district. Similarly, when a zip code is split between three districts, one-third of the impacted veterans in the zip code are assumed to be in each congressional district. The House Republican proposal would provide two benefits to two groups of veterans: those who would receive Combat-Related Special Compensation, and those who would receive relief from the disabled veterans tax. The DOD Actuary provided zip code-level data on the veterans affected by the disabled veterans tax, but could provide only national-level data on the veterans who would receive Combat-Related Special Compensation under the House Republican proposal. The analysis thus assumes that the distribution of these veterans by zip code is similar to the distribution of veterans who would receive relief from the Disabled Veterans Tax under the proposal. Electronic mail from DOD Actuary to Committee on Government Reform, Minority Staff (Oct. 21, 2003).

The Disabled Veterans Tax Costs Veterans in North Carolina Millions of Dollars Annually

Statewide, the Disabled Veterans Tax costs veterans \$12.9 million each month in lost disability benefits. This is equivalent to \$155 million annually.

On a per-veteran basis, the Disabled Veterans Tax costs each of the 25,890 impacted veterans in North Carolina an average of \$5,980 annually.

The average retired veteran in North Carolina receives retirement benefits of approximately \$17,100 annually. The Disabled Veterans Tax reduces benefits for affected veterans in the state by an estimated 26%.

Appendix 1 contains information on the effect of the Disabled Veterans Tax in each of the congressional districts in North Carolina.

Legislation To Eliminate the Disabled Veterans Tax Would Have Significant Benefits in North Carolina

Legislation cosponsored by over 350 members of the House, the Retired Pay Restoration Act of 2003 (H.R. 303), would eliminate the Disabled Veterans Tax for all retired veterans with at least 20 years of service. Passage of H.R. 303 would result in increased benefits for 25,890 veterans in North Carolina. These veterans would receive an increase in benefits of \$155 million annually.

The Republican Proposals to Reduce the Disabled Veterans Tax Would Provide Only Limited Help for Veterans

House Republicans have proposed legislation that would phase out the Disabled Veterans Tax for a limited group of veterans over ten years. DOD data indicate that in 2004, this proposal would provide only \$46.7 million in relief from the Disabled Veterans Tax for only 9,233 veterans in North Carolina. Even when fully phased in, in 2014, the legislation would provide only limited relief. Among the veterans in North Carolina who are currently subject to the Disabled Veterans Tax, only 9,233 would be entitled to relief in 2014, and the total relief they receive would be limited to only \$121 million.¹³

Compared to the Republican proposal, the legislation sponsored by Reps. Watt, Price, Etheridge, McIntyre, Ballance, and Miller, H.R. 303, provides significantly more relief from the Disabled Veterans Tax. Statewide, H.R. 303 would provide

¹³ This figure is in 2004 dollars. Cost of living increases would increase the absolute amount received by veterans, but the inflation-adjusted value of these payments would remain the same.

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benefits for almost three times as many veterans as the Republican proposal. In dollar terms, H.R. 303 would provide a total benefit of over three times the size of the benefit provided under the Republican proposal in 2004.

CONCLUSION

An 1891 law prevents disabled veterans from receiving both military retirement and VA service-connected disability compensation. As a result, hundreds of thousands of military veterans are forced to pay the Disabled Veterans Tax, effectively reducing their benefits by billions of dollars each year. This analysis finds that 25,890 disabled veterans in North Carolina are forced to pay the Disabled Veterans Tax. Reps. Watt, Price, Etheridge, McIntyre, Ballance, and Miller have supported efforts to pass legislation that would eliminate the Disabled Veterans Tax for these veterans.

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Appendix 1: Impact of the Disabled Veterans Tax by Congressional District in North Carolina

District Number	Representative	Number of Veterans in District Who Lose Benefits to the Disabled Veterans Tax	Total Annual Lost Benefits	Average Lost Benefits Per Veteran	% of All Qualifying Retired Veterans in District Who Lose Benefits to the Disabled Veterans Tax	% of Affected Veterans Helped by House Republican Legislation
NC-1	Frank W. Ballance Jr.	1,497	\$8,480,300	\$5,664	21%	35%
NC-2	Bob Etheridge	3,411	\$20,859,481	\$6,115	44%	36%
NC-3	Walter B. Jones	4,984	\$31,410,974	\$6,303	40%	41%
NC-4	David E. Price	1,013	\$5,439,815	\$5,370	33%	29%
NC-5	Richard Burr	795	\$4,753,185	\$5,982	26%	34%
NC-6	Howard Coble	1,221	\$6,756,102	\$5,534	29%	30%
NC-7	Mike McIntyre	4,361	\$26,951,017	\$6,180	38%	36%
NC-8	Robin Hayes	4,127	\$25,034,952	\$6,067	55%	35%
NC-9	Sue Wilkins Myrick	711	\$3,771,454	\$5,303	25%	30%
NC-10	Cass Ballenger	731	\$4,271,777	\$5,846	28%	34%
NC-11	Charles H. Taylor	1,290	\$8,016,864	\$6,217	25%	35%
NC-12	Melvin L. Watt	928	\$4,761,694	\$5,133	34%	28%
NC-13	Brad Miller	806	\$4,289,086	\$5,320	25%	31%